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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 77-12

CONTINENTAL OIL COMPANY, ET AL.,
Appellants,

v.

MARVIN MANDEL, GOVERNOR OF THE STATE OF MARYLAND, ET AL.,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF MARYLAND

JURISDICTIONAL STATEMENT

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ON APPEAL FROM THE
COURT OF APPEALS OF MARYLAND

JURISDICTIONAL STATEMENT

Appellants, Continental Oil Company ("Continental") and Kayo Oil Company ("Kayo"), appeal from the judgment of the Court of Appeals of Maryland, entered on April 13, 1977.[1] Continental and Kayo submit this statement to show that the Supreme Court of the United

[1] The decision of the Maryland court reversed a judgment of the Circuit Court for Anne Arundel County, Maryland on separately filed but later consolidated actions brought by appellants and Exxon Corporation, Shell Oil Company, Gulf Oil Company, Phillips Petroleum Company, Commonwealth Oil Refining Company, Inc. and Petroleum Marketing Corporation, and Ashland Oil Company. Although each of the foregoing parties are filing separate appeals to this Court, they have joined in the filing of a common appendix to their respective jurisdictional statements.

States has jurisdiction of this appeal and that substantial federal questions are presented.

OPINIONS BELOW

The opinion of the Court of Appeals of Maryland, filed on February 18, 1977, and captioned below as *Governor of the State of Maryland, et al. v. Exxon Corporation, et al.*, is reported at 279 Md. 410 (1977) and also at 370 A.2d 1102. The supplemental opinion of the court of appeals denying motions for reconsideration and stay of judgment is reported at 279 Md. 456.[2] The opinion of the Circuit Court for Anne Arundel County, Maryland is not officially reported.[3]

JURISDICTION

Continental and Kayo filed a bill of complaint on June 28, 1974, in the Circuit Court for Anne Arundel County, Maryland, seeking a declaration that a Maryland statute, Chapter 854 of the Laws of Maryland, 1974, violated the Maryland and United States Constitutions. They further sought to enjoin the enforcement of that statute by the defendant State officials ("the State"). The Circuit Court for Anne Arundel County, Maryland, in a consolidated ruling on the actions brought by appellants and seven other plaintiffs seeking the same or similar relief, entered a judgment declaring that Chapter 854, as amended by Chapter 608 of the Laws of Maryland, 1975, was unconstitutional and void. The circuit court also enjoined the State from enforcing the Maryland statute.

The Court of Appeals of Maryland reversed the judgment of the circuit court and held that Chapter 854, as amended, did not violate either the Maryland or

[2] The court of appeals' opinion and supplemental opinion are printed in the common appendix, Appendices A and B, at 1a and 45a.

[3] The circuit court's opinion is printed in the common appendix, Appendix D, at 53a.

federal constitutions. On April 13, 1977, the court of appeals denied timely motions for reconsideration and stay of mandate filed by Continental and Kayo. The circuit court entered a judgment declaring Chapter 854, as amended, constitutional and valid on April 18, 1977. Notices of appeal to this Court[4] were filed in the circuit court and the court of appeals on June 27, 1977; the record having been returned to the circuit court when the court of appeals issued its mandate on April 13, 1977.

Jurisdiction of this appeal is conferred upon the Supreme Court by 28 U.S.C. §1257(2) (1970) in that the Court of Appeals of Maryland has declined to hold unconstitutional a statute of that state. The following decisions of this Court sustain its jurisdiction to review the judgment on direct appeal in this case: *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937); *Dahnke-Walker Milling Co. v. Bondurant*, 257 U.S. 282 (1921); *Western Turf Ass'n v. Greenberg*, 204 U.S. 359 (1907).

CONSTITUTIONAL PROVISIONS AND STATUTES

Constitutional Provisions

U.S. Const., Article I, Section 8, Clause 3 — "The Congress shall have Power . . . To regulate Commerce with Foreign Nations and among the several States, and with the Indian Tribes".

U.S. Const., Amendment XVI- "[N]or shall any State deprive any person of . . . property without due process of law; . . . ."

Statutes

The provision of the Maryland statute involved in this appeal is paragraph C of Chapter 854 of the Laws

[4] The notices of appeal are printed in the common appendix, Appendix E, at 139a.

of Maryland, 1974, as amended by Chapter 608 of the Laws of Maryland, 1975,[5] codified as MD. ANN. CODE art. 56, §157E(c), Vol. 5B at 43 (1976 Cum. Supp.). Paragraph (c) provides (1975 amendments in italics):

> (c) After July 1, 1975, no producer or refiner of petroleum products shall operate a major brand, secondary brand, or unbranded service station in the State of Maryland, with company personnel, a subsidiary company, commissioned agent, *or under a contract with any person, firm, or corporation managing a service station on a fee arrangement with the producer or refiner. The station must be operated by a retail service station dealer.*

QUESTIONS PRESENTED

1. Whether paragraph C of the Act, which prohibits all producers and refiners of petroleum products from operating retail service stations in the State of Maryland and requires that they divest themselves of existing company-operated stations, is unconstitutional because it is an improper exercise of the State's police power and constitutes a deprivation of property without due process of law.

2. Whether paragraph C of the Act violates the commerce clause because it places an undue burden on the stream of petroleum products in interstate commerce and shelters local service station dealers from out-of-state competitors, thereby discriminating against interstate commerce.

STATEMENT OF THE CASE

A. THE PROCEEDINGS BELOW

On May 31, 1974, the Act in question was signed into law by the Governor of Maryland, effective July 1, 1974. The Act contains five provisions which affect the retail marketing of petroleum products in Maryland. After

[5] Chapter 854 (1974 Md. Laws) and Chapter 608 (1975 Md. Laws) are hereinafter collectively referred to as "the Act".

July 1, 1974, all producers or refiners of petroleum products are prohibited from opening and directly operating retail service stations. After July 1, 1975, all producers or refiners of petroleum products are prohibited from operating their existing company-operated retail service stations in Maryland. The Act further requires that all producers, refiners and wholesalers extend voluntary allowances and equipment rentals uniformly to their service station dealers and that gasoline be apportioned uniformly on an equitable basis to all Maryland dealers.

In their bill of complaint Continental and Kayo challenged the constitutional validity of two provisions of the Maryland Act: (i) paragraph B prohibiting producers or refiners from opening a new retail service station and operating it through anyone other than a retail service station dealer; and (ii) paragraph C prohibiting a producer or refiner from operating an existing retail service station in Maryland through anyone other than a retail service station dealer. They contended in the circuit court that both provisions of the Act were an invalid exercise of the State's police power in violation of the due process clause of the fourteenth amendment and the commerce clause of the United States Constitution. Continental and Kayo did not challenge the validity of the other provisions of the Act which regulate marketing practices between producers, refiners and wholesalers and their dealers because neither market petroleum products at retail in Maryland through service station dealers.

Similar actions for declaratory and injunctive relief were filed in the circuit court by seven other producers and/or refiners of petroleum products.[6] Exxon, Shell,

[6] Exxon Corporation, Gulf Oil Company, Phillips Petroleum Company, Petroleum Marketing Corporation, Commonwealth Oil Refining Company, Inc., Ashland Oil Company and Shell Oil Company.

Gulf and Phillips challenged the validity of all provisions of the Act because, as fully integrated oil companies, they market their petroleum products at retail in Maryland both through dealers and company-operated stations. Ashland[7] and P.M.C.[8], like Kayo, market their petroleum products in Maryland at retail exclusively through company-operated stations, and do not market through independent dealers. Consequently, they also limited their challenges to the constitutional validity of paragraphs B and C of the Act.

Following the trial of the consolidated cases, the circuit court entered a judgment declaring that all provisions of the Act were unconstitutional and void and enjoined the enforcement of the Act by the State. The circuit court's holding was based primarily on the ground that the Act violated the due process clauses of the Maryland and federal constitutions.

The State appealed from the judgment of the circuit court to the Court of Special Appeals of Maryland. The Court of Appeals of Maryland issued a writ of certiorari prior to a decision by that intermediate appellate court. On February 18, 1977, the court of appeals reversed the judgment of the circuit court and held that all provisions of the Act were constitutional and valid. With respect to paragraphs B and C of the Act, the court adversely decided the constitutional challenges of appellants and the other plaintiffs, holding that "the Court below erred in holding that the Act was violative of the Due Process Clause of the Fourteenth Amendment . . ."; and that "the divestment provisions of the

[7] Ashland is primarily a refiner and marketer of petroleum products in that it produces less than 15% of the crude oil which it subsequently refines.

[8] P.M.C. is a wholly-owned subsidiary of Commonwealth and engages solely in the marketing of petroleum products. Commonwealth is a refiner of petroleum products which is totally dependent upon foreign crude oil supplies.

Maryland Act are not unconstitutional under the Commerce Clause."

Following the denial of motions for reconsideration and stay of mandate by the court of appeals on April 13, 1977, and the entry of a judgment by the circuit court declaring the Act constitutional and valid, Continental and Kayo timely filed this appeal.

B. Facts Material to the Consideration of the Questions Presented

During the trial of the consolidated cases in the circuit court, the testimony of 13 witnesses as well as numerous affidavits, exhibits and stipulations were admitted into evidence. Since Continental and Kayo are limiting the questions presented by this appeal to the constitutionality of paragraph C of the Act, only facts material to these questions are presented.

Crude oil is neither produced nor refined in Maryland. Consequently, all gasoline sold in the state is produced, refined and transported from outside the state. The only operations engaged in by producers and refiners in Maryland are the distribution and marketing of their petroleum products.

Continental is a fully integrated oil company engaged in the production, refining, transportation and marketing of petroleum products. Kayo, its wholly-owned subsidiary, engages solely in the retail marketing of gasoline in 18 states. It presently operates 14 stations in Maryland. Continental does not operate any service stations or sell its branded gasoline ("Conoco") in Maryland. The petroleum products brought by Continental into the State are refined by it at a Louisiana refinery and then transported through an interstate pipeline to a Baltimore terminal. Its products are then sold in Maryland through retail service stations operated by Kayo or to Continental's wholesale purchasers located in Maryland and other states.

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As of July 1, 1974, the effective date of the Act, 34 companies sold gasoline in Maryland under 40 different brands at approximately 3,800 retail service station outlets. The vast majority of retail outlets were operated by independent service station dealers. Only 245 stations, approximately 6% of the total number of retail stations in Maryland, were company-operated stations. Twenty-one different producers and/or refiners sold gasoline at retail in Maryland through 209 company-operated stations.[9] Of the remaining company-operated stations, 36 were operated by independent marketers who neither produce nor refine petroleum.

During the period 1972 through 1974, the total number of retail stations in Maryland declined. Similarly, the number of company-operated stations declined in Maryland and nationally. Because of the number of retail outlets that sell gasoline and the variety of ways in which gasoline is offered to the Maryland consumer, the State conceded in this case that *the retail marketing of petroleum products in Maryland is a highly competitive industry.*

Kayo markets its gasoline at retail in Maryland (and nationally) through high volume, low price, gasoline only, company-operated stations. It is identified in the industry as a private brand marketer. As such, it has the following marketing characteristics common to all private brand marketers: (i) its brand is not advertised; (ii) it provides no repair services or facilities; (iii) it does not accept credit cards; and (iv) its principal marketing tool is the price of its gasoline, which is lower than the price of gasoline at a major brand station.[10]

[9] Under the Maryland Act, a "company-operated station" is one which is operated directly by a company with its own employees, employees of a subsidiary company or commissioned agents, and under its own brand name.

[10] A major brand marketer (such as Exxon, Shell and Gulf) utilizes a different concept of marketing in that its brand name is widely recognized through advertising, it offers repair services, accepts credit cards, and places its marketing emphasis on methods of competition such as service and credit.

The vast majority of private brand stations are company-operated, whereas most major brand stations are operated by independent service station dealers. The private brand marketers' reliance upon company-operated stations is founded upon legal and economic considerations. In order for a private brand marketer to compete with the major brands, it is essential that it sell its gasoline at a lower price. The motoring public, because of its lack of recognition of private brands which do not advertise, accept credit cards or offer repair services, would opt to purchase a major brand of gasoline if both major and private brands were being sold for substantially the same price. Consequently, private brand marketers strive to reduce overhead, operate their stations longer hours, project a low-priced image and maintain competitive prices that are generally one to four cents per gallon below major brand marketers. To achieve these results requires control over the operation, marketing and pricing practices of each station. Such control cannot be implemented legally through independent retail dealers. It can be implemented both practically and legally through company-operated stations.

Under paragraph C of the Act, Kayo must either turn the operation of its retail service stations over to independent dealers or discontinue retail marketing of gasoline in Maryland. Should Kayo attempt to market through dealers, it will be unable to control its dealers' methods of operation and pricing practices. Without control over these aspects of its marketing program, Kayo will be unable to dictate a lower price for its gasoline and remain competitive in Maryland with major brand marketers. Consequently, Kayo will have no choice but to cease its retail operations in Maryland

and withdraw from the state because it will be economically infeasible for it to continue to market at retail.[11]

THE FEDERAL QUESTIONS ARE SUBSTANTIAL

A. Introduction

Producers and refiners historically have engaged in the direct retail sale of gasoline to consumers through company-operated stations. Prior to the Maryland Act, it was lawful for a producer or refiner to market in this manner.[12] The ability to directly sell gasoline through existing company-operated stations, all of which are owned by Kayo, constitutes a valuable property right.

Maryland was the first state in the nation to enact legislation prohibiting producers and refiners of petroleum from owning and operating retail service stations. Similar statutes were subsequently enacted in Florida, Delaware and the District of Columbia. Bills which prohibit the ownership and operation of retail stations by producers or refiners have been introduced into the legislatures of eleven other states.[13] The decision of the Court of Appeals of Maryland is the first decision of a highest court of any state holding that such legislation is not violative of the federal constitution.[14]

[11] Kayo and two other private brand marketers, Ashland and P.M.C., testified in the circuit court that if paragraph C of the Act is held valid, they will be forced to close their retail outlets in Maryland.

[12] To continue to sell gasoline at retail through company-operated stations subjects producers and refiners to criminal sanctions under the Maryland Motor Fuel Inspection Law, Article 56, §§157F(g) and 157K (1972 Repl. Vol. 1976 Cum. Supp.).

[13] Rhode Island, Massachusetts, New Hampshire, New Jersey, Maine, Washington, Oregon, New York, Illinois, North Carolina and Connecticut.

[14] The Florida statute was held unconstitutional by a trial court under that state's constitution. Exxon Corp. v. Conner, Case No. 74-1449 (Cir. Ct., 2d Jud. Cir., Leon County, Fla., Jan. 23, 1975). On June 20, 1977, the Supreme Court of New Hampshire answered questions submitted to it by the New Hampshire legislature with respect to the constitutionality of a statute similar to the Maryland Act pending before the legislature. One of the provisions of the proposed statute prohibits suppliers from engaging in retail operations, similar to paragraphs B and C of the Maryland Act. A majority of the court held that a retrospective application of that provision would constitute an unlawful taking of property in violation of the New Hampshire constitution. In all other respects, the court was of the opinion that the proposed statute was constitutional. Opinion of the Justices, No. 7804 (New Hampshire Sup. Ct. June 20, 1977).

Paragraph C constitutes a radical departure from traditional governmental economic regulation. Maryland has not mandated divestiture because of any transgression on the appellants' part violative of the antitrust laws,[15] nor does paragraph C address itself to an industry deemed a regulated monopoly,[16] or one which clearly involves the public health or requires special expertise.[17] It requires producers and refiners to

[15] *See,* United States v. Paramount Pictures, Inc., 334 U.S. 131 (1948); Standard Oil Co. v. United States, 221 U.S. 1 (1911). Business conduct deemed inimical to the public welfare, although not violative of the antitrust laws, may also be remedied by divestiture. *See, e.g.,* Daniel v. Family Security Life Ins. Co., 336 U.S. 220 (1949).

[16] *See, The Hepburn Act,* 49 U.S.C. 1(8) (1959) (The commodities clause of the Hepburn Act prohibits railroads from transporting commodities manufactured, produced or mined by them, thereby preventing railroads from utilizing their exclusive operating rights and attendant ratemaking powers from taking unfair advantage of non-rail competitors); *The Public Utilities' Holding Company Act,* 15 U.S.C. 79(k) (1971) (This act requires public utility holding companies to dispose of unrelated utilities and holdings with the view towards consolidating them into single, intelligently integrated and organized systems).

[17] *See,* North Dakota State Board of Pharmacy v. Snyders Drug Stores, Inc., 414 U.S. 156 (1973) (pharmacies); Ferguson v. Skrupa, 372 U.S. 726 (1963) (debt adjusting); Williamson v. Lee Optical of Okla., Inc., 348 U.S. 483 (1955) (optometry).

discontinue the direct sale of gasoline and to divest themselves of their company-operated stations through which they market gasoline at retail in Maryland because they are producers and refiners — because they are vertically integrated. To date, no legislative body or court has required a corporation, vertically integrated through internal expansion, to divest itself of a segment of its operations solely because it was vertically integrated.[18]

The sole business of Kayo in Maryland is the direct sale of gasoline at retail through company-operated stations. Appellants are being required under paragraph C to discontinue the direct sale of gasoline at retail and to divest existing company-operated stations simply because Continental engages in the production and refining of petroleum products. Although the Maryland court believed that the Act "merely regulates a wholly intrastate activity, the retail marketing of gasoline within the state", paragraph C exceeds "mere regulation". Kayo is prohibited from continuing its business by virtue of that provision. It therefore is being deprived of its valuable right to do business by direct retail sales in Maryland.

In this appeal, appellants focus their attention solely on the constitutionality of paragraph C. The fundamental question presented here is whether Maryland can prohibit appellants consistent with the due process and commerce clauses from continuing to sell their products to consumers simply because they are vertically integrated.

[18] *See,* Note, *Gasoline Marketing Divestiture Statutes: A Preliminary Constitutional and Economic Assessment,* 28 VAND. L. REV. 1277, 1315 (1975). This Court has held that direct retail marketing by a vertically integrated company is not *per se* unlawful. United States v. Arnold, Schwinn & Co., 388 U.S. 365, 381 (1967); United States v. Columbia Steel Co., 334 U.S. 495, 519-26 (1948).

B. PARAGRAPH C OF THE ACT IS AN IMPROPER EXERCISE OF THE STATE'S POLICE POWER AND CONSTITUTES A DEPRIVATION OF PROPERTY WITHOUT DUE PROCESS OF LAW.

By enacting paragraph C, Maryland sought to regulate its internal commercial and business affairs by prohibiting producers and refiners of petroleum products from continuing to operate existing company owned and operated retail stations. A state's authority to enact economic regulatory legislation under its police power is not without limitation; this court has long recognized that "states have [the] power to legislate against what are found to be injurious practices . . . so long as their laws do not run afoul of some specific federal constitutional prohibition". *Lincoln Federal Labor Union v. Northwestern I. & M. Co.,* 335 U.S. 525, 536 (1949).[19]

Prior to *Nebbia v. New York,* 291 U.S. 502 (1934), this Court frequently struck down under the due process clause state laws regulatory of business and industrial conditions because they were "unwise, improvident or out of harmony with a particular school of thought". *Williamson v. Lee Optical of Okla., Inc.,* 348 U.S. 483, 488 (1955). Whether the ends of a statute were appropriate and legitimate was a matter of judicial determination, the Court focusing in these cases on the nature of the legislative objective itself. *See,* Note, *Due Process Limitations on Occupational Licensing,* 59 VA. L. REV. 1097, 1112 (1973). The Court reserved unto itself the role of a "super-legislature, [weighing] the wisdom

[19] *See also,* Roe v. Wade, 410 U.S. 113, 152-56 (1973) (A state's power to regulate abortions during the early stages of pregnancy must defer to women's right of privacy); Schware v. Board of Bar Examiners, 353 U.S. 232 (1957) ("A State cannot exclude a person from the practice of law or from any other occupation in a manner or for reasons that contravene the Due Process . . . Clause of the Fourteenth Amendment". *Id.* at 238-39).

of legislation". *Day-Brite Lighting, Inc. v. Missouri*, 342 U.S. 421, 423 (1952).

Nebbia and its progeny have established that this Court no longer judges the purpose or the desired ends of a legislative economic scheme, nor does it substitute its "social and economic beliefs for the judgment of legislative bodies who are elected to pass laws". *Ferguson v. Skrupa*, 372 U.S. 726, 730 (1963). The Court can examine, however, such legislation to determine whether the means employed by a state bear a rational relation to a constitutionally permissible objective. In *Nebbia v. New York, supra*, 291 U.S. at 525, this Court held that due process does not prohibit governmental regulation for the public welfare, but merely conditioned the exercise of that power "by securing that the end . . . be accomplished by methods consistent with due process". The Court further held that the means selected by a state must have "a real and substantial relation to the objective sought to be attained". *Id.* As this Court later stated, "[i]t is enough that there is an evil at hand for correction, and that it might be thought that the particular legislative measure was a rational way to correct it". *Williamson v. Lee Optical of Okla., Inc., supra*, 348 U.S. at 488.[20] Thus, this Court has reviewed regulations to determine if the means employed by the state were rationally related to its objective.[21] *See, e.g., Usery v. Turner Elkhorn Mining*

[20] One of the state regulations held constitutional in *Williamson* was a provision which prohibited optometrists from renting or occupying space in a retail store. In reversing the district court's ruling, this Court identified the legislative objective as an attempt to free a profession from all taints of commercialism and held that the regulation had a "rational relation to that objective and therefore . . . [was not] beyond constitutional bounds". 348 U.S. at 491.

[21] In several of these decisions, the Court did not discuss the end-means test, but limited its discussion to whether the state had the power in conjunction with the fourteenth amendment to establish the end. *See, e.g.*, North Dakota

Co., 428 U.S. 1, 21 (1976) (Fifth Amendment Due Process Case — "It is enough to say that the Act approaches the problem . . . rationally"); *Ferguson v. Skrupa*, 372 U.S. 726, 733 (1963) (Harlan J., concurring "on the ground that this state measure bears a rational relation to a constitutionally permissible objective"); *Daniel v. Family Security Life Ins. Co.*, 336 U.S. 220, 224 (1949) ("[We cannot] say that the statute has no relation to the elimination of those evils").

In bringing this appeal appellants seek a determination whether the means selected by the Maryland Legislature, divestiture, bear a rational relationship to the Act's objectives. This determination is not foreclosed by the Court's prior decisions.[22]

In its opinion, the Court of Appeals of Maryland defined the objectives sought by that state's legislature in enacting paragraphs B and C of the Act. The court did not expressly determine whether paragraph C bore a rational relation to those objectives. Because paragraph C does not bear a rational relation to the Act's objectives, appellants contend that the Maryland court erred in holding that that provision did not violate the due process clause.

The first objective of the Act found by the Maryland court was to prevent refiners and producers from favoring company-operated stations in the allocation of gasoline, causing service station dealers to close because of their inability to obtain adequate supplies. [illegible] require producers and refiners to divest themselves [illegible] their existing company-operated stations is not a

State Board of Pharmacy v. Snyder's Drug Store, Inc., 414 U.S. 156 (1973).

[22] A review of cases such as *Usery, Ferguson, Williamson, Daniel* and *Nebbia* indicates that this Court is empowered to hold state regulatory legislation violative of the due process clause where the statute's means are not rationally related to constitutionally permissible objectives.

rational means by which to accomplish the objective of fair allocation of gasoline. In a companion provision to paragraph C of the Act, the Maryland Legislature prohibited unfair allocation of gasoline and required that producers and refiners not discriminate against dealers in their allotments. That provision, paragraph F of the Act, accomplishes the legislative objective of fair allocation and does so in a rational manner. To require Kayo and other producers and/or refiners which do not market in Maryland through dealers to cease operating their existing company-operated stations so as to insure that other producers and refiners allocate gasoline fairly to their dealers constitutes an irrational method of accomplishing this objective. To effect this drastic result in order to achieve that particular objective cannot conform with due process.

The second purported objective was to curb the conversion of dealer operated stations to company operation. This objective is accomplished by paragraph B of the Act, rather than paragraph C. To require divestiture of existing company-operated stations clearly does not constitute a rational means by which to prevent an increase of company-operated stations.

The third purported objective was to preserve and enhance competition in the retail gasoline market and prevent monopolistic control of gasoline marketing by a few companies. Whether paragraph C's prohibition against the operation of existing company-operated stations bears a rational relation to this objective requires a close scrutiny of the existing Maryland market. To prohibit 21 producers and/or refiners from operating 209 retail outlets cannot serve to prevent monopolistic control of gasoline marketing "by a few companies". No company or group of companies selling gasoline in Maryland through 209 company-operated stations can conceivably exert monopolistic control over a retail market consisting of approximately 3,800

stations. The danger of monopolistic control might exist only in the event that producers and refiners increased their number of company-operated stations in the future. Paragraph C, which prohibits producers and refiners from operating their existing stations, has no rational relation to the prevention of this evil or to the accomplishment of this objective.

Nor does paragraph C serve to either preserve or enhance competition in Maryland's retail market. It is established, and the State has conceded in this case, that the gasoline retail market in Maryland is a highly competitive one. Kayo and other private brand marketers, such as Ashland and P.M.C., have exerted a pro-competitive influence on the Maryland market, traditionally offering to consumers the lowest gasoline prices in the state. Because it is essential for private brand marketers to sell at retail through company-operated stations, paragraph C's prohibition will impair their Maryland operations or cause these marketers to discontinue them. Appellants contend that the impairment or elimination of existing competitors from a currently competitive market is not a rational means to accomplish the objective of preserving and enhancing competition.[23] As the market presently exists, Kayo and other private brand marketers promote competition. Given the current Maryland market, there is no danger to competition if producers and refiners are permitted to continue operating their 209 outlets. Consequently, it is irrational to bar them from competing in the Maryland market under the guise of preserving and enhancing competition. Divestiture of *existing* stations is, therefore, not a rational means to accomplish the Act's objectives.

[23] The only expert who testified on behalf of the State at trial conceded that the elimination of such private brand marketers as Ashland and P.M.C. from the Maryland retail market would be anti-competitive.

Whether Maryland can mandate divestiture to accomplish its purported objectives raises two questions. First, does the concept of substantive due process impose *any* limitation on the nature and extent of state regulation of business and commercial interests? Second, do the means embodied in paragraph C rationally relate to the Maryland Act's objectives in conformity with due process? These federal constitutional questions should not be decided by the highest court of any one state, but should be decided by this Court with the benefit of full briefs on the merits and oral argument.

C. Paragraph C of the Act Violates the Commerce Clause Because It Places an Undue Burden on the Stream of Petroleum Products in Interstate Commerce and Shelters Local Service Station Dealers from Out-Of-State Competitors, Thereby Discrimination Against Interstate Commerce.

To determine whether paragraph C of the Act is repugnant to the commerce clause requires an examination of the market affected by paragraph C and the practical effect of that provision on the market. Appellants contend that such an examination impels the conclusion that paragraph C constitutes an unlawful regulation of and burden upon interstate commerce.

1. *The Market Affected by Paragraph C*

The record in this case established that all gasoline sold in Maryland is both produced and refined outside the state and then transported through interstate commerce into Maryland. Gasoline is sold to the consumer through approximately 3,780 retail outlets, of which 245 are company-operated stations. Of these, 209 are directly operated by 21 producers or refiners of petroleum products, and 36 are identified in this case as being operated by gasoline marketers who are neither

producers nor refiners.[24] The remaining 3,535 outlets are operated by independent service station dealers. Almost all of the independent dealers represent purely local interests. All 21 producers or refiners who sell gasoline at retail in Maryland through 209 company-operated stations are interstate competitors in the Maryland market and compete with 3,571 retail stations which are operated almost exclusively by local interests.

2. *The Practical Effect of Paragraph C on the Market*

Paragraph C of the Act mandates that all producers or refiners of petroleum products discontinue the operation of their existing company-operated stations and cease marketing their petroleum products directly to the consumer in Maryland. As that provision clearly commands, "[t]he station must be operated by a retail service station dealer". Consequently, the 209 retail stations which are operated by 21 producers or refiners must either cease operation or be turned over to dealers. The practical effect of paragraph C is to eliminate 21 existing interstate competitors from directly marketing their products at retail in Maryland, shielding Maryland dealers from the competition generated by interstate competitors. As such, paragraph C constitutes a burden on the prosecution of interstate business.

An analysis of a state tax, regulation or prohibition on interstate commerce begins with the principle that "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States". *Boston Stock Exch. v. State Tax Comm'n*, 97 S. Ct. 599, 606 (1977), citing *Great Atlantic & Pac. Tea Co. v. Cottrell*, 424 U.S. 366 (1976) and *McLeod v. J. E.*

[24] Of the 36 outlets operated by gasoline marketers who are neither producers nor refiners, an undetermined number are not Maryland based businesses.

Dilworth Co., 322 U.S. 327, 330 (1944). This Court has invalidated state statutory provisions which on their face or in effect violate the free trade philosophy embodied in the commerce clause. A state statute that unduly burdens commerce by discriminating against interstate competitors for the purpose of shielding domestic industries and markets from interstate competition violates the commerce clause. *See, e.g., Boston Stock Exch. v. State Tax Comm'n*, 97 S. Ct. 599 (1977); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949); *Best & Co. v. Maxwell*, 311 U.S. 454 (1940); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935).

In *Best & Co. v. Maxwell*, 311 U.S. 454 (1940), the Court reviewed a North Carolina statutory provision which levied an annual privilege tax of $250 on every person or corporation, not a regular retail merchant in the state, who displayed samples in a hotel room rented or occupied temporarily for the purpose of securing retail orders. Local retail merchants were subject to an annual tax of $1 for the privilege of conducting a retail business. The Court found this scheme to be inherently discriminatory in violation of the commerce clause, holding:

> "[t]he freedom of commerce which allows the merchants of each state a regional or national market for their goods is not to be fettered by legislation, the actual effect of which is to discriminate in favor of intrastate businesses, whatever may be the ostensible reach of the language."

Id. at 457

In *Best & Co.*, North Carolina afforded non-resident interstate competitors three options. They could either establish themselves as regular North Carolina retail merchants, cease doing business at retail in the state or pay $250 for the privilege of conducting retail sales.

Maryland reduces the options available to producers and refiners, all of whom are interstate competitors, by requiring that they turn their retail operations over to dealers or cease conducting direct retail sales in the state through their company-operated stations.

Paragraph C's prohibition goes beyond imposing a tax on interstate competitors; it totally excludes them from the market place and places the retail sale of gasoline almost solely in the hands of local merchants. Because a tax on interstate competitors was deemed in *Best & Co.* to "discourage and hinder the appearance of interstate commerce", it was held that the tax unduly burdened interstate commerce. To prohibit the presence of interstate competitors in the Maryland retail market constitutes a more formidable barrier that protects almost exclusively local interests (i.e., Maryland dealers) against competition generated from outside the state. *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 (1949).[25] The erection of this barrier constitutes discrimination against appellants and cannot stand in view of the commerce clause.[26] *See, e.g., Polar Ice*

[25] The Maryland Court of Appeals found that the Act did not discriminate against out-of-state interests as opposed to local interests since if there were local producers or refiners, they would also be subject to the Act. This ignores the current make-up of the Maryland market, and the practical effects of the Act. Furthermore, in Dean Milk Co. v. City of Madison, 340 U.S. 349 (1949), this Court, in striking down an ordinance requiring all milk sold in the city to be bottled at an approved plant within five miles of the city, stated that it was immaterial that other intrastate operators were subject to the same prohibition as the interstate competitor. *Id.* at 354 n.4.

[26] As recently stated by the Court in Boston Stock Exch. v. State Tax Comm'n, 97 S. Ct. 599, 607 (1977), citing Dean Milk Co. v. City of Madison, *supra*, 340 U.S. at 354: "The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects".

Cream & Creamery Co. v. Andrews, 375 U.S. 361 (1964); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951); *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511 (1935).

Discrimination against interstate competitors in favor of purely local interests is not the only effect on interstate commerce imposed by paragraph C. If Kayo were to opt to sell its gasoline at retail through dealers in Maryland, it would incur substantial expenses in establishing and managing a dealer network, and an additional margin of profit (i.e., the dealer) would result in an increase in the cost of its gasoline to the consumer. This increase in price will burden commerce. However, to opt to market through dealers is not a viable alternative. In order for Kayo to compete with major brand dealers, it must sell its gasoline at a lower price. In order to assure its ability to control the price of its gasoline, it must be able to set that price. As stated by the State's expert at trial, this control is "absolutely the crux of the success of the discount marketer". Absent this ability to control price, and its resultant effect on the ability to compete in the market, Kayo and other private brand marketers will be required to withdraw from the retail sale of gasoline in Maryland.[27] Their withdrawal will lessen the availability of gasoline in Maryland, impair competition, and consequently burden commerce.

As exemplified in *Dean Milk Co.*, this Court is not required to accept any explanation, however transparent, and may seek out the true impetus and motivation behind a legislative action and analyze the actual probable working of that action when commerce is involved. Accordingly, the Court may review the evidence and determine for itself the real purposes and actual effect of a statute. *Great Atlantic & Pac. Tea Co. v. Cottrell, supra*, 424 U.S. at 375. The circuit court below explored the genesis of the Act and found:

> "In all the more than one hundred eighty-five pounds of pleadings, motions, briefs, exhibits and depositions before this court, there is *no concrete evidence* that the act was justified as to the classes of operators singled out to be affected in order to promote the general welfare of the citizens of the State. *Rather, it is apparent that the entire bill was designed to benefit one class of merchants to the detriment of another* . . . .
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> "The court finds that apart from there not being demonstrated a real and substantial relation to the object sought to be attained by the means selected, the evidence presented before it indicates that *the statute is inversely related to the public welfare.*" (Emphasis added).

If the true purpose of paragraph C was to benefit existing local operators of 3,535 stations at the expense of their interstate competitors, as found by the circuit court, that provision must fail as discriminatory and "directly burden[ing] the prosecution of interstate business". *Baldwin v. G.A.F. Seelig, Inc., supra*, 294 U.S. at 522.

The Maryland Court of Appeals was of the opinion that its state's interests in enacting the Act outweighed any burden which its provisions imposed on interstate commerce. The court stated that the purpose of the Act was "to preserve competition within the retail gasoline marketing industry in Maryland". The court also stated the Act would prevent misallocation of gasoline during

[27] The Maryland court attached little weight to the testimony of Kayo, P.M.C. and Ashland that the Act would require them to withdraw from the Maryland market because of the absence of a "firm decision" to withdraw. To require a final decision prior to a determination of the Act's validity is unreasonable. Greater weight should have been attached to this uncontroverted evidence compelling the inevitable conclusion that a prohibition against company-operated stations would force their withdrawal from the market.

periods of shortage, and that the legislature concluded that "the recent trend of increased direct operation of service stations by producers and refiners [which] if allowed to continue, could substantially decrease competition and lead to the control of that market by a few major oil companies".

As recently stated by this Court in *Hunt v. Washington Apple Advertising Comm'n,* No. 76 — 63 (decided June 20, 1977), "[w]hen discrimination against commerce . . . is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives, adequate to preserve the local interests at stake." *Id.* at 18. In the instant case, as in *Hunt,* the State failed to sustain that burden.

If the purpose of the Act was to preserve competition in the Maryland market, paragraph C does not accomplish this purpose. The removal of existing competitors from a competitive market cannot serve to preserve competition. *See* Argument B, *supra.* Nor does paragraph C serve to prevent misallocation of gasoline by appellants because they and most other private brand marketers do not sell at retail through dealers. Further, if the purpose was to prevent any *increased* direct operation of service stations by producers and refiners, paragraph C is not intended to accomplish that purpose.

Assuming *arguendo* that paragraph C relates to the purported purposes of the Act ascribed to it by the Maryland court, it must still fail because the state interests "could be promoted as well with a lesser impact on interstate activities". *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142 (1970). Paragraph B of the Act, if constitutional, prohibits producers and refiners from opening and operating new stations or converting existing ones to company operation and forestalls any increase in the direct operation of service stations by producers and refiners which might conceivably affect competition.

Paragraph F of the Act prohibits misallocation of gasoline. Thus, paragraphs B and F could be said to accomplish the purported objectives of the Act without prohibiting appellants from continuing their existing retail operations in Maryland, and do so in a manner less burdensome to appellants' interstate activities.

The Maryland court was also of the opinion that the Act "merely regulate[d] a wholly intrastate activity, the retail marketing of gasoline within the state"; and that "[p]roducers and refiners would still remain free to import and sell petroleum products to wholesalers and to retail service station dealers". The existence of an alternative method of marketing products by an interstate competitor does not cure a commerce clause infirmity. In *Uni-Worth Enterprises, Inc. v. Cleveland,* 412 F. Supp. 349 (N.D. Miss. 1976), a city ordinance prohibited anyone from replacing automobile windshields at a customer's residence. Even though the city established that substitute locations were available at a minimal cost whereby the plaintiff corporation, operating in interstate commerce, could conduct its business, the court held the ordinance violative of the commerce clause. The court stated "such . . . procedure[s] would be a great detriment to plaintiff in successfully operating its business". *Id.* at 352. Thus, to restrict appellants' market to wholesale purchasers and retail dealers cannot serve as a substitute to engaging in a vital segment of its integrated operations — direct retail sales.

Moreover, the retail sale of gasoline is not a "wholly intrastate activity". Such an interpretation of the commerce clause is too narrow. In determining whether a commercial process involves interstate commerce, this Court has not confined itself to a single segment of that process. *See e.g., Gulf Oil Corp. v. Copp Paving, Inc.,* 419 U.S. 186 (1974). Rather, the Court considers additional factors such as the interstate sources of the

products and the number of interstate travelers patronizing the business. *See e.g., Daniel v. Paul,* 395 U.S. 298 (1969); *Katzenbach v. McClung,* 379 U.S. 294 (1964). The standard to be employed in determining whether interstate commerce is involved is whether the activity in question implicates or affects commerce. *Wickard v. Filburn,* 317 U.S. 111 (1942).

All of the gasoline sold in Maryland is produced and refined outside the state. Instrumentalities of interstate commerce are employed in transporting the gasoline into the state. Further, gasoline brought into Maryland is sold to persons traveling in interstate commerce. This process constitutes a stream of commerce, the retail sale being merely the final step before use. *See, Federal Trade Comm'n v. Sun Oil Co.,* 371 U.S. 505 (1963); *Standard Oil Co. v. Federal Trade Comm'n,* 340 U.S. 231 (1951).[28]

Vertically integrated operations, by their very nature, stretch across the borders of any one state and implicate commerce The fundamental defect found in paragraph C is that it is aimed at regulating a national industry which extends beyond Maryland's borders. As stated by Justice Cardozo: "[i]t is the established doctrine of this Court that a state may not, in any form or under any guise, directly burden the prosecution of interstate business". *Baldwin v. G.A.F. Seelig, Inc., supra,* 294 U.S. at 522.

Paragraph C undermines the philosophy embodied in the commerce clause that this country be one free market. Because of the effect of that provision on appellants, other producers and refiners in Maryland and the motoring public, the Maryland court's decision

[28] The Congress of the United States deemed the retail sale of petroleum to be within the commerce clause when it enacted the Emergency Petroleum Allocation Act of 1973, 15 U.S.C. §751, *et seq.* (1973).

should be reviewed to determine whether divestiture mandated by paragraph C comports with that clause.

CONCLUSION

For the foregoing reasons, the questions presented in this appeal should be given plenary consideration and resolved by this Court with benefits of briefs on the matter and oral argument.

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